2013

Mid-year EM Strategy Update

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Building on principles

Mirae Asset Global Investments

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*Source: Investments & Pensions Europe, January 2013

Executive Summary

During the first half of 2013, emerging equity markets significantly underperformed that of the developed markets due to concerns over weakening economic growth momentum and large fund outflows following news of a potential tapering of quantitative easing in the U.S. In Asia, markets struggled as the export led recovery across the region showed signs of fatigue and concerns on the scale of off-balance sheet lending in China re-emerged. Emerging Europe, Middle East and Africa (EMEA) and the Latin American region were negatively impacted by the drop in oil and commodity prices deriving from the bleak global economic outlook.

As we enter the second half of the year, taking a selective approach on stocks is pure necessity amid market conditions plagued by high uncertainty and anxiety. Economic rebalancing and re-adjustments will regularly act as roadblocks to global economic recovery, and although we believe there will be continued market concerns over a potential end to quantitative easing in the U.S., we expect that globally, central banks will continue to funnel liquidity into the market. As investors realize that Central Bankers remain vigilant to prevent tail risks and global liquidity remains ample, we feel investor interest will again return to quality companies and this is where we seek to remain positioned.

Asia – Despite a recent downturn in the regional outlook for Asia, with the U.S. showing steady GDP growth and European industrial activities stabilizing, it is highly likely that Asian economic data may surprise the market to the upside in the traditionally strong second half of the year. We plan to maintain our preference for consumers and health care given their high earnings visibility with industrials and resources being our least preferred. We also reiterate our key investment themes of: 1) Rising consumer aspirations in the Asia ex Japan region backed by rising income; 2) Ageing populations and the rising demand for health care related services; 3) Improving productivity and smart living; 4) Funding infrastructure demands in the emerging markets and consumer growth; and 5) Clean and efficient energy.

EMEA – In Russia, we remain positive on consumer companies and banks that are set to benefit from the structural growth story, of stable growth in retail sales and loan growth, respectively. In Turkey, as we expect to witness a meaningful acceleration in the economy backed by a rebound in domestic demand, despite recent protests, we plan to focus on companies that will benefit from economic growth and increased domestic consumption. Meanwhile, we remain cautious on South African equities given slow economic growth, anticipation of future labor unrest, and heightened vulnerability to the Rand.

Latin America – Although Mexican banks and retailers are anticipating a recovery in the latter half of the year, we expect earnings to remain soft. Meanwhile, Brazil remains out of favor given weak earnings momentum and stagnant economic data. Thus our preference remains on secular domestic growth stories such as Brazilian retail and apparel, banks across the Latin American region, health care and insurance.

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Asia

After posting a sharp rally from late November 2012 to February 2013, Asian stock markets have largely struggled in 2Q2013 as the export led recovery across the region showed signs of fatigue and concerns on the scale of off-balance sheet lending in China re-emerged. From a single country perspective, ASEAN countries including Malaysia, Indonesia and the Philippines posted positive returns backed by strong earnings while China and Korea were the biggest laggards due to concerns over slow growth and the negative impact of the weak Japanese Yen, respectively[1].

As we enter the second half of 2013, we expect stock specific performance to dominate in the absence of a strong macroeconomic upturn. The slowdown in economies and rolling over in exports that has been visible for the last 2-3 months was evidence that the stock markets were running ahead of the real economy somewhat. This effect has been most pronounced in ASEAN countries. However, post the recent 15%-20% correction in USD terms for India and ASEAN, we maintain our belief that the structural story is intact and now that valuations are more attractive, stocks seem priced for a slowing growth environment. Economic rebalancing and re-adjustments will regularly act as roadblocks to global economic recovery, and although we believe there will be continued market concerns over a potential end to quantitative easing in the U.S., we expect that globally, central banks will continue to funnel liquidity into the market. The BOJ in particular is scheduled to aggressively purchase bonds to meet a 2% inflation target. As investors realize that Central Bankers remain vigilant to prevent tail risks and global liquidity remains ample, we feel investor interest will again return to quality companies. Within such a framework, we will continue to focus on stocks with stable earnings growth and high dividend yields as well as stocks with high earnings visibility such as those in the consumer and health care sectors.

Economists seem to have turned extremely pessimistic on the Asian Regional Outlook. However, with the outlook for the U.S. showing steady GDP growth and European purchasing managers' indexes (PMIs) stabilizing, it is highly likely that Asian economic data surprises the low market expectations in the traditionally strong second half of the year. With this in mind, we reiterate that our key investment themes will continue throughout 2H2013: 1) Rising consumer

[1] As of 14 June 2013, based on individual MSCI indices in USD terms

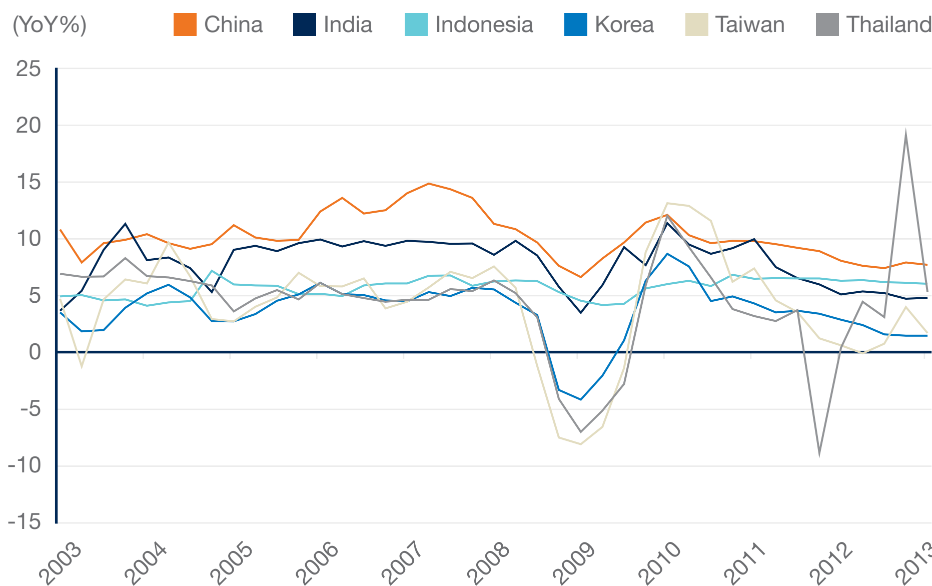
aspirations in the Asia ex Japan region backed by rising income; 2) Ageing populations and the rising demand for health care related services; 3) Improving productivity and smart living; 4) Funding infrastructure demands in the emerging markets and consumer growth; and 5) Clean and efficient energy.

Weakening Growth Momentum

Amid a slow recovery in the U.S. and recession in Europe, underlying trends in Asia seem to have weakened. 1Q2013 GDP growth in Asia has slowed due to a drop in exports and slowing manufacturing activities. The saving grace in exports has been inter-Asia trade which has compensated for the drop-off in exports to the EU which have been the most severely impacted.

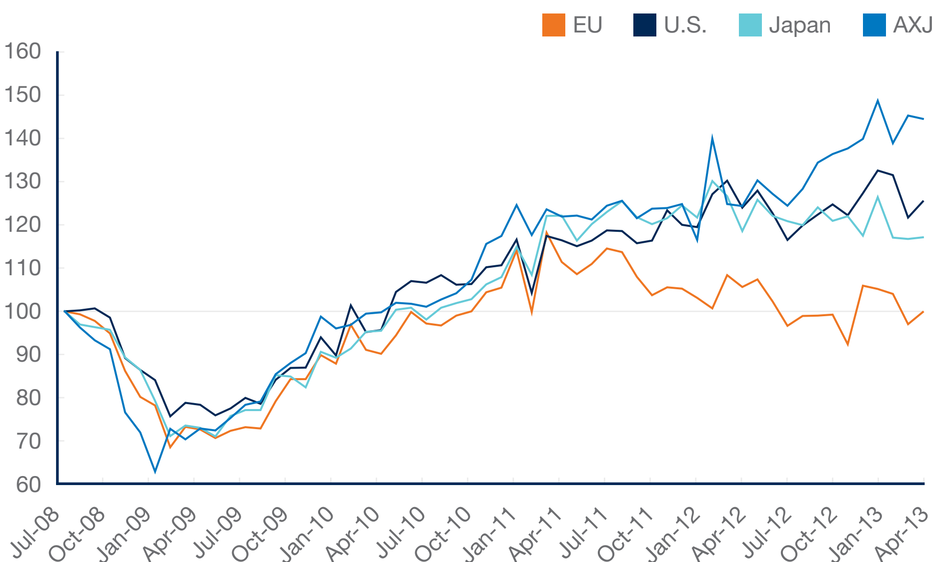
In China, weak exports have led to a drop in the HSBC Manufacturing PMI to below the neutral 50-level, comparably lower than the 1Q2013 average of 51.5[2]. Sales slowed to 12.9% yoy in May, slightly missing the government's target, while FAI growth was around 20%[3]. Equity markets are particularly anxious by the sharp jump in off balance sheet total social financing in China which has

Real GDP Growth (YoY %)



Source: CEIC, as of May 2013

Asia ex Japan Export Index (SA, 2008=100)



Note: AXJ excluding Indonesia, which have released Apr 2013 exports data and take up 96% of the region's total exports
Source: CEIC, Morgan Stanley Research, as of May 2013

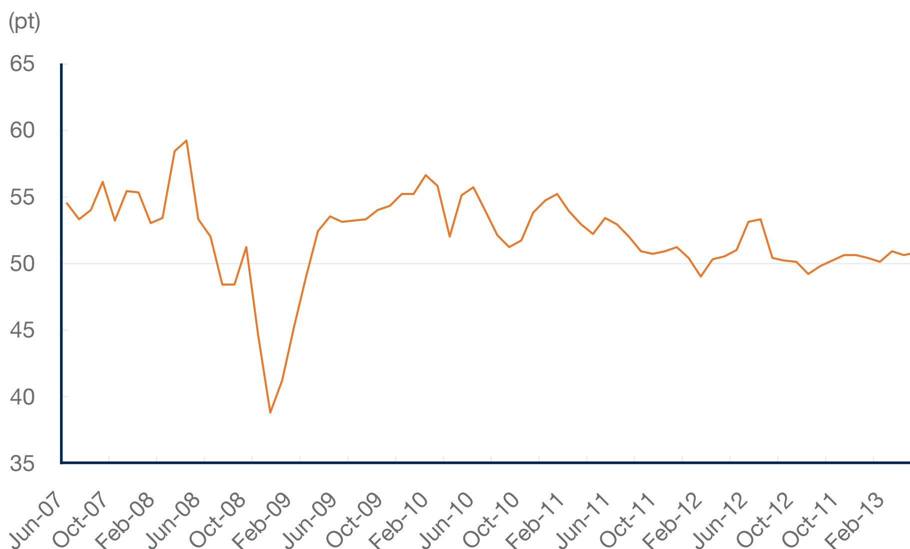
[2] Source: HSBC, as of May 2013.
[3] Source: Bloomberg, as of May 2013.

further increased indebtedness of the economy. Korean retail sales continued to be weak despite monetary easing, with the Bank of Korea cutting the repo rate by 25 bps to 2.5% in May, its third cut in the current cycle. Taiwan also witnessed a sharp drop in imports.

Similar trends have been witnessed throughout the ASEAN countries. Malaysia and Thailand both reported lower-than-forecast GDP growth data of 4.1% and 5.3% in 1Q2013, due to contracting industrial production and falling exports, respectively. However, in Malaysia, the positive contribution from domestic consumption and infrastructure investment was a notable exception to otherwise weak data.

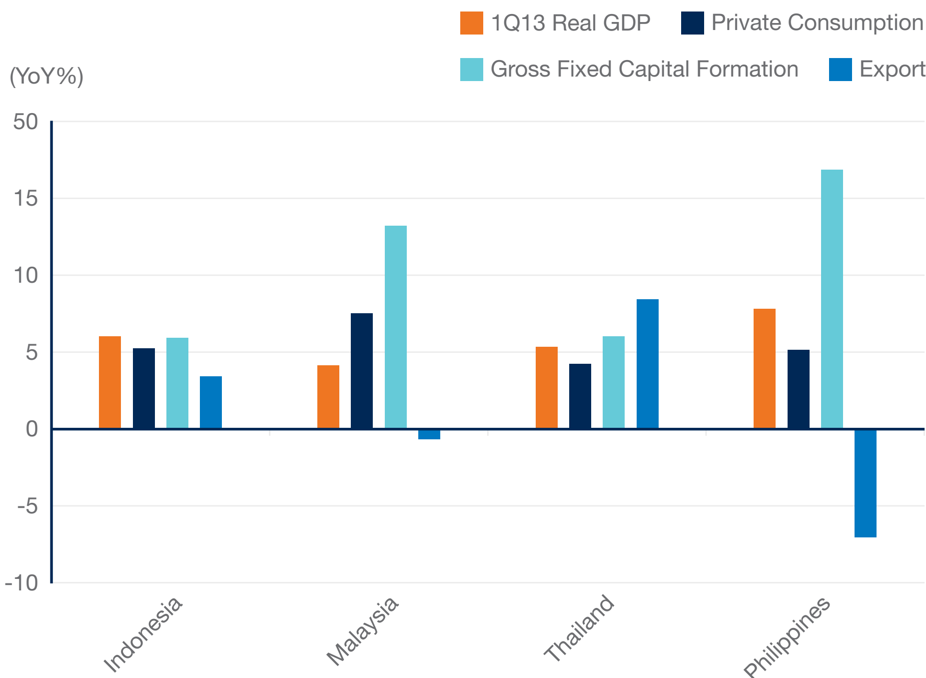
Signs of a slowdown in private consumption in Thailand and Indonesia emerged after the front ending of demand that was triggered by the introductions of incentives such as tax breaks and wage hikes by the government last year. Although the Bank of Thailand has voiced concerns about overheating in the Thai property market, we view it as likely that the central bank will cut the interest rate by 25 bps to 2.5% to stem baht appreciation and maintain growth momentum. In Indonesia, the balance of payment deficit has led to a decline in foreign currency reserves and accordingly the weaker than expected GDP growth

China Manufacturing PMI (SA)



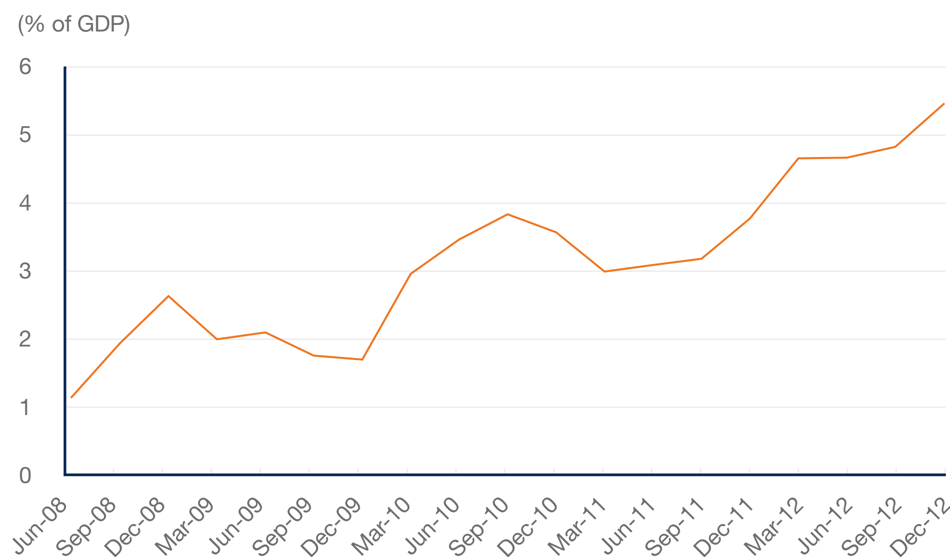
Source: Bloomberg, as of May 2013

ASEAN 1Q2013 GDP by Expenditure (YoY % change)



Source: Bloomberg, as of May 2013

India Current Account Deficit



Source: Bloomberg, as of May 2013

of 6.0% in 1Q2013. The government is attempting to prudently manage the situation by appointing an investment friendly reformist as the new Finance Minister and we expect the central bank to raise interest rates to curb consumption and investment growth in the country.

In terms of macro-economic health, the Philippines is clearly the standout performer within the ASEAN region with low inflation and a steady broad money supply. Business confidence rose to a record high in 2Q2013 which is likely to translate into strong investment growth. Not surprisingly, S&P upgraded the nation's credit rating to BBB- stable on the back of a strong current account surplus.

In India, the current account deficit continued to be the nation's Achilles heel, worsening again in 2Q2013. We believe that after the recent spurt of gold imports, a slowing economy and weak investment cycle will help to ease the current account deficit. Landmark FDI deals may also remove some of the pressure. Meanwhile, with wholesale inflation falling below 5% for the first time in 41 months, additional interest rate cuts of between 50 to 75 bps are expected by March 2014. Nevertheless, despite monetary easing, we do not expect the investment cycle to significantly recover ahead of the general elections in 2013, thus growth remaining below the 6% level.

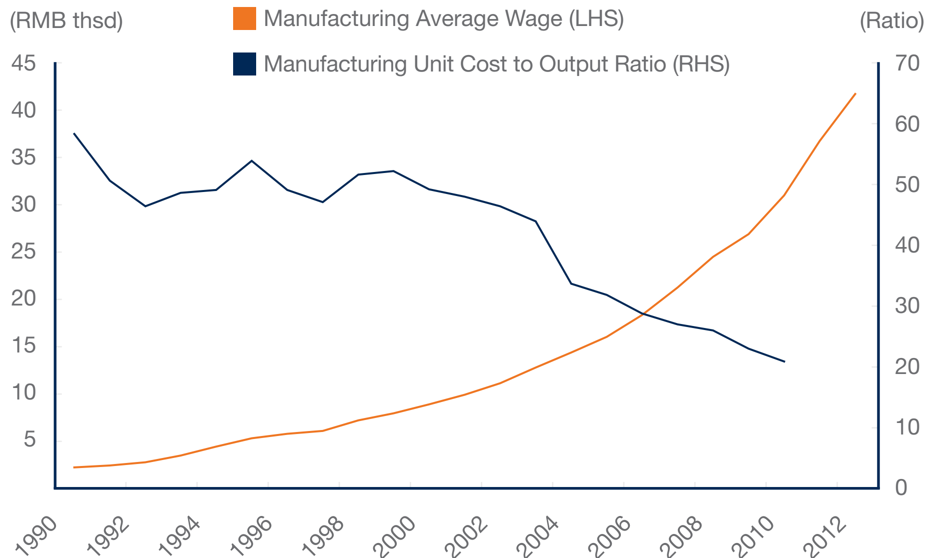
Given such an economic backdrop, we continue to be overweight in Hong Kong/China primarily through large stable pan regional companies listed in Hong Kong, in India through exporter and consumption names, and in Thailand and Indonesia primarily through consumption related companies. We plan to maintain our underweight in Korea and Taiwan due to a combination of long-term issues such as poor demographics and short-term constraints such as weak domestic demand and lack of growth in the traditional export growth drivers of technology and heavy industry. Sector-wise, we still maintain our preference for consumers and healthcare given their high earnings visibility with industrials and resources being our least preferred.

Chinese Consumption – Resilience sustained

Our broad thesis of Chinese consumption being relatively resilient has been proven by the fact that despite a sharp jump in wages over the past five years, the level of U.S. and EU imports from China has remained at 21-23%. Wage inflation has been somewhat mitigated by improving productivity and a strong logistical advantage over other low-wage countries such as India, Vietnam, and Bangladesh.

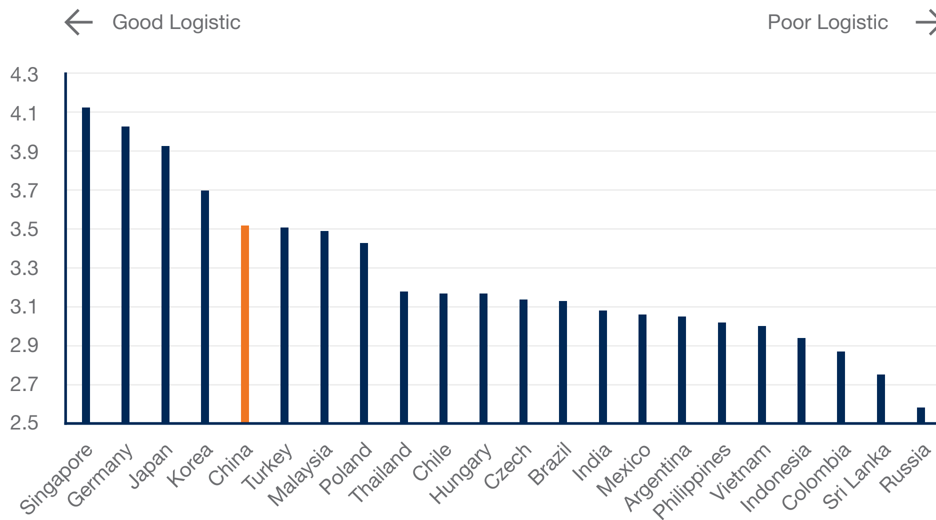
In 2000, China was barely 9% of U.S. and EU imports but this has increased to 23% over the past decade, backed by a strong push from local governments and huge infrastructure build ups. China's exports are around US$ 2 trillion and in the case of low-wage countries such as Thailand, Indonesia, Bangladesh and Vietnam, if they had experienced similar growth, a mere 5% shift (approximately US$ 100 billion) in increased exports would entail a 50-400% growth in their current export base. We can see the strength that Chinese exports hold, in that despite the Indian Rupee having depreciated nearly 35% against the Chinese Yuan since 2008, Chinese exports to India have grown significantly over the same period. This is a clear demonstration that the advantage in logistics and economies of scale that China holds is an extremely important factor and its current logistical advantage

Manufacturing – Wage vs. Efficiency/Productivity



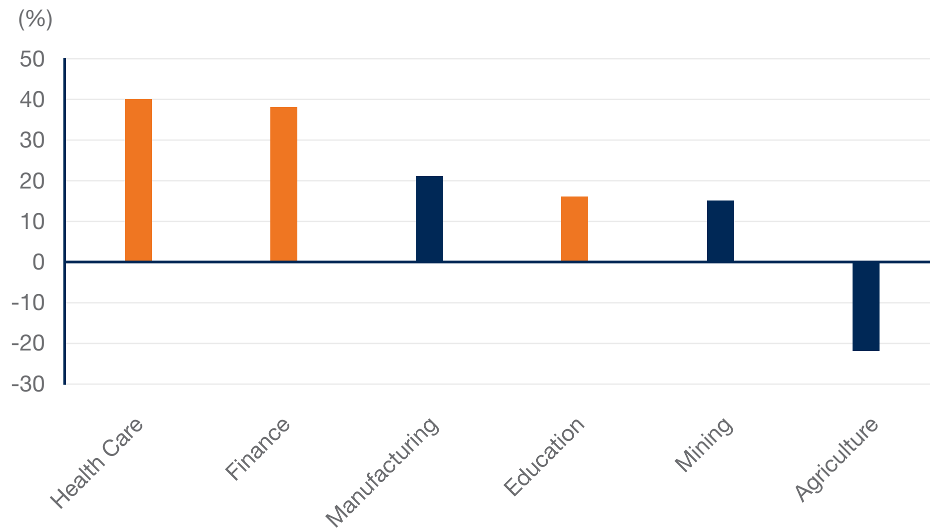
Source: CEIC, as of 2012

Logistics Performance Measure (2012)



Source: World Bank, as of May 2013

Change of Employment 2007-2010 (%)



Source: China National Bureau of Statistics, as of May 2013

is going to make it tough for other low-wage countries to simply supplant China as Asia's export powerhouse.

In addition, the tertiary sectors' overall share of employment, i.e. employment in services, has gone up from 32.4% in 2006 to 36% in 2012 with sectors like finance, education and health care showing healthy growth in employment since 2007. This is in contrast to the high unemployment witnessed in 2008 and 2009. Thus, it is our view that despite sluggish growth trends in the economy, there are no structural issues regarding consumption and a move towards consumption patterns that more closely resemble those in the West will continue.

The imbalances in the Chinese economy are largely a function of poor capital allocation by inefficient SOEs and infrastructure investments that are initiated too early and not matched to realistic levels of demand. Our view is that the industries that would be most impacted by this rebalancing are the industrials, commodity and financial sectors. Consumer companies are likely to be less impacted as limited growth in the pool of labor should prevent large scale unemployment and private enterprises are likely to balance wage pressures with improving productivity. Consequently, we continue to still hold a preference for regional consumer names such as Macau casinos, and China tourism companies.

Europe, the Middle East and Africa (EMEA)

Similar to the Asian markets, after a strong rally since late November 2012, the stock markets in the Emerging Europe, Middle East and African region plunged in 1H2013 on weak economic indicators combined with weak oil and commodity prices. Due to a bleak global growth outlook, oil and commodity prices have hovered at or below their 2012-averages.

Nonetheless, pockets of opportunity within the region remain. In Russia, we remain positive on consumer companies and banks that are set to benefit from the structural growth story, of stable growth in retail sales and loan growth. Despite recent protests, we expect to witness meaningful acceleration in the Turkish economy backed by a rebound in domestic demand. Thus, it is important to be selective in Turkey and invest in names that will benefit from economic growth and increased domestic consumption. Meanwhile, we remain cautious on South African equities given slow economic growth, anticipation of future labor unrest, and heightened vulnerability to the Rand.

Russia

Russia's economy has slowed but appears to be bottoming out. GDP grew by only 1.6% in the first quarter and while consumption is driving economic growth, investment activity is almost flat. Unlike in 2012, the government is unlikely to provide much of a stimulus given its adoption of new budget rules that limit the size of the non-oil fiscal deficit.

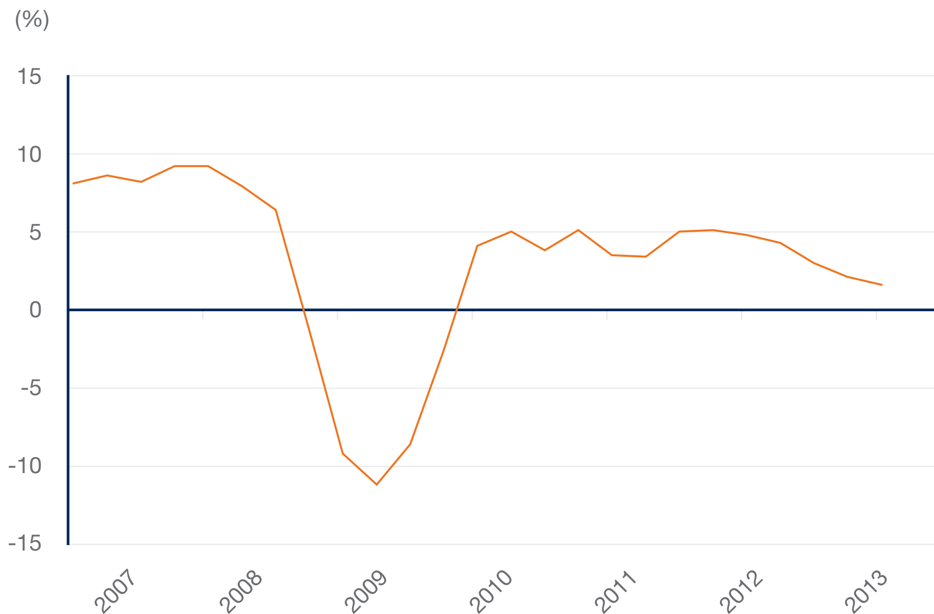
In the absence of strong commodity price growth, the consumer has been propping up the economy with retail sales, real disposable income, and real wages all being firmly in positive territory, while unemployment remains near record low levels. Inflation remains elevated at 7.0%, but should moderate toward 6% by year-end due to base effects. To combat slowing growth, the Central Bank will likely move to an easing stance and cut interest rates starting in 3Q2013 for a total of 50 to 75 bps in cuts this year. Given the above backdrop, unless oil and other commodity prices drop (or rise) meaningfully, we expect economic growth of under 3% in 2013.

President Putin's administration has now been in office for a year, and it has been a year which has been marked by a notable lack of meaningful reforms. The administration has only implemented small measures such as increased corruption probes and provided general statements talking about the need to improve basic

services such as education and healthcare. In the absence of meaningful reforms, President Putin has taken an increasingly populist tone. He has been chastising government officials for not delivering on election promises, and recently sacked a second minister, to lift his sagging approval ratings. However, the government has of yet been unwilling to undertake necessary structural reforms, which has led to concerns within the market that government policy may turn more populist and lead to an even looser fiscal policy.

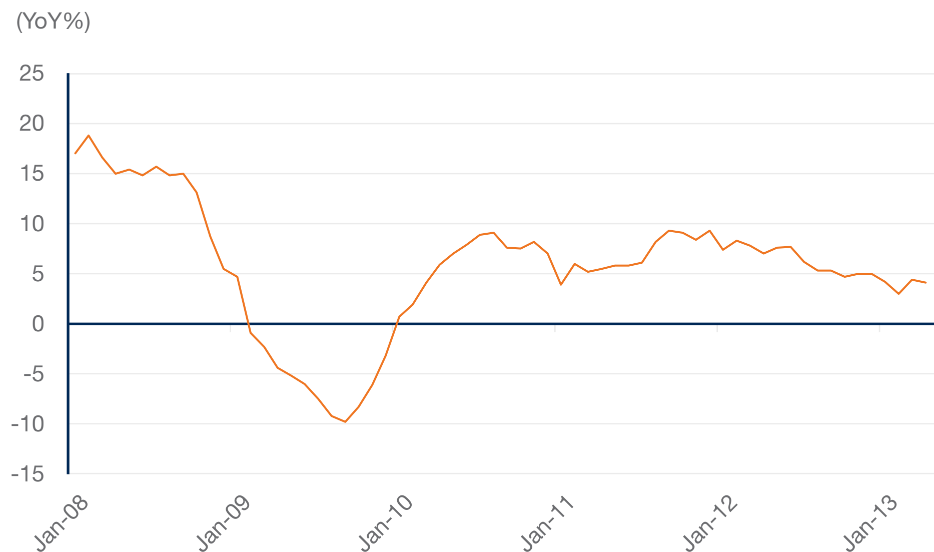
The Russian equity market has underperformed emerging markets year-to-date in line with weak oil and other commodity prices. Russia's discount to emerging market equities remains at an all-time high although we feel the discount is partially justified due to the lack of positive momentum on structural reforms, and the unexciting commodity price outlook. Nonetheless, pockets of opportunity still exist. The consumer remains strong and loan growth, while decelerating, is still one of the highest in emerging markets. Furthermore, any improvement in economic growth globally will help some of the beaten down, cheap cyclical stocks in Russia, although we view this as premature at this stage. We therefore remain positive on consumer companies and banks that are levered to the consumer and benefit from the structural growth story.

Russia GDP Growth Trend



Source: Bloomberg, as of May

Russia Retail Sales YoY Change



Source: Bloomberg, as of May

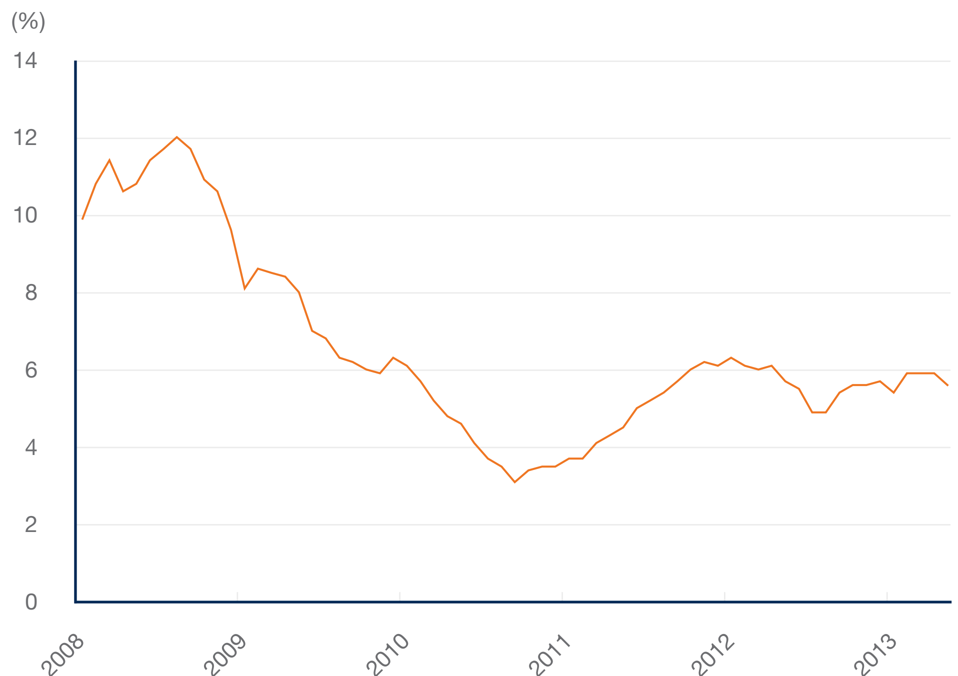
South Africa

South African economic growth continues to be lackluster with first quarter GDP coming in at a weak 1.9% yoy growth. The PMI has fluctuated around 50, indicating uncertainty over economic conditions and the consumer continues to prop up the economy, but the tailwinds of increasing social grants and strong real wage growth are fading. Against this backdrop, retail sales remain positive, and employment grew in the first quarter by 1.5%, however, these levels are not enough to sustain trend economic growth. Manufacturing remains weak and renewed labor unrest in the mining sector will likely hurt mining volumes and an extremely tight electricity reserve could lead to reduced economic output. Inflation appears to have peaked at 5.9% in April, just below the Reserve Bank's upper band of 6%. Inflation has thus far not been impacted by the depreciation in the Rand which continues to weaken; this is mainly due to the depreciation being relatively gradual. The Reserve Bank remains on hold, but given weak economic indicators, the possibility of an interest rate cut has increased. Given the headwinds the South African economy is facing, we expect economic growth of between 2% and 2.5% in 2013. On the political front, the government has been pushing for job creation and better service delivery to the broader population, but has yet to pass any meaningful measures. The government's

South African Kagiso PMI (SA)

Source: Bloomberg, as of May 2013

Inflation



Source: Bloomberg, as of May 2013

biggest challenge will be to reign in fiscal spending, as much of the growth in government spending in recent years has come from increased wages to government employees. Given the increasing militancy of unions, if the government cannot contain wage growth, the fiscal deficit could widen even further from the expected deficit of 4.5% of GDP and in such a scenario we would expect the Rand to weaken further. Overall, the government continues to focus on transfer payments to the populace rather than address South Africa's structural issues of high labor costs, poor education, and high income inequality.

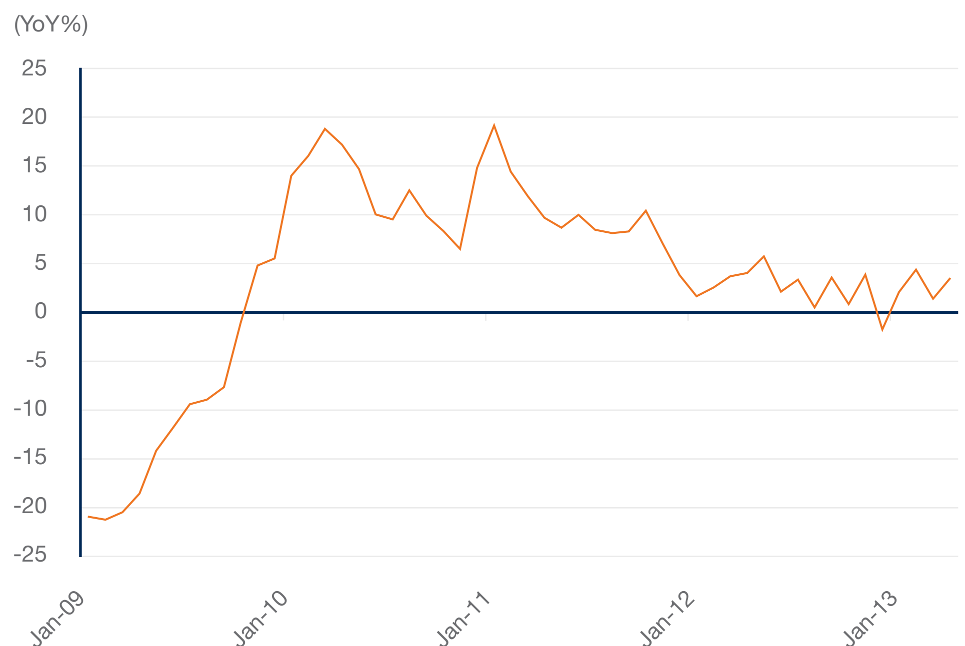
We remain circumspect on South African equities given the slow economic growth, anticipation of future labor unrest, and heightened vulnerability to the Rand. Due to the increasing vulnerability of the consumer we are particularly cautious on consumer companies, but remain positive on select names that benefit from low interest rates and have above trend earnings growth either from a secular growth story perspective or because of margin expansion potential. The healthcare sector remains attractive due to its defensive characteristics and the existence of a structural growth story. Alternatively due to the likelihood of further labor unrest and escalating costs, we believe that the materials sector should be avoided.

Turkey

Turkish economic growth remains in an upward trend. Industrial production has been rebounding since the beginning of the year and the manufacturing PMI remains firmly in an expansion zone. Consumer spending is also improving as evidenced by auto sales increasing 15% yoy in May. Inflation, while elevated, fell to 6.5% in May versus 7.3% in March. The Central Bank has maintained a dovish stance to encourage growth and implemented an across-the-board 50 bps cut in all short-term interest rates. While the current account deficit remains wide and a cause for concern, recent commodity price weakness has helped keep it under control and we believe that economic growth should recover to around 4% in 2013.

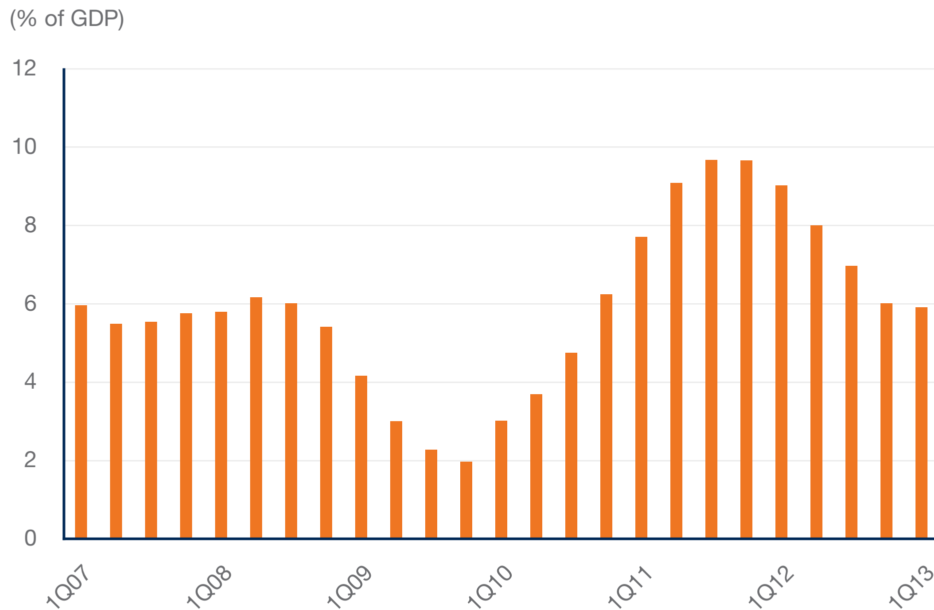
After years of political stability, Turkey is currently undergoing its greatest political unrest in 15 years. What started out as protests to halt a development of a park in Istanbul has morphed into widespread discontent against what some perceive as an increasingly heavy-handed and authoritarian government. The government has oscillated between seeking reconciliation and taking a hard line with the protesters, and thus at the time of writing it is difficult to predict how the situation will be resolved. Nonetheless, barring a huge escalation in protests,

Turkey Indusinal Production (YoY%)



Source: Bloomberg, as of May 2013

Turkey Current Account Deficit (as% of GDP)



Source: Bloomberg, as of May 2013

economic fallout should be limited. There is a risk the government may become more populist with upcoming local elections in 2014, but given the lack of credible political opposition to the AK Party, we do not see a risk of a change in government in the near-term.

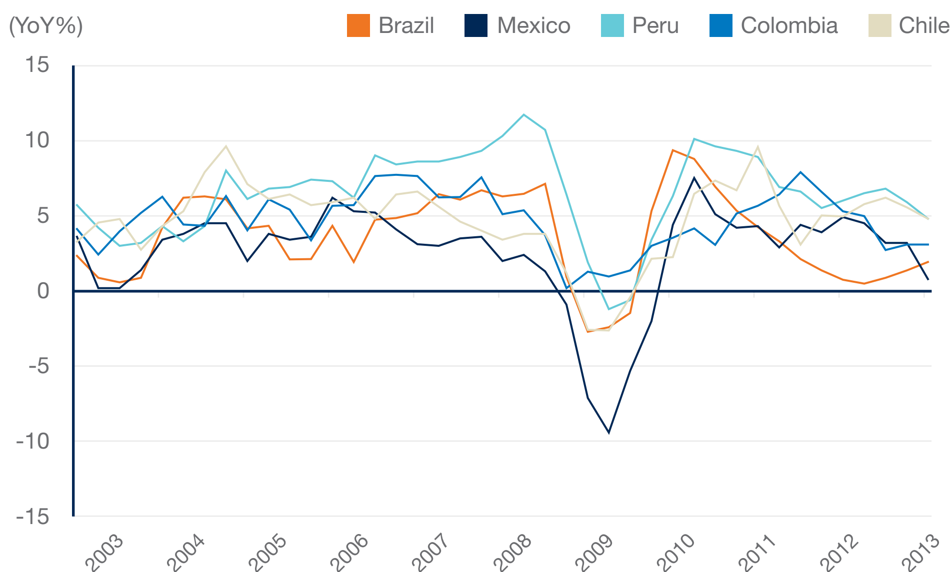
The equity market has performed strongly YTD and prior to the recent outbreak of political unrest is ahead of emerging markets this year. After the recent sell-off which saw the market drop close to 15% from its peak, valuations on select names whose earnings outlook are at little risk due to the protests have become significantly more attractive. We maintain a cautious stance on the equity market as we expect increased volatility while political instability continues but still remain positive on the economy as a whole and see upside in certain segments of the equity market. Driven by a rebound in domestic demand, we expect meaningful acceleration of economic growth for the remainder of the year. As a result, we believe investors should be positioned in those companies and sectors most poised to benefit from a rebound in GDP growth, and in particular those exposed to increased domestic consumption such as auto companies and select banks.

Latin America

Latin America has remained one of the weakest performing regions across global equities YTD, with all major markets in the region registering negative absolute returns in USD terms. Mexico has been the relative outperformer while Peru has been the main laggard. Moreover, regional currencies have weakened across the board with the BRL sharply depreciating since the end of last year to the R$ 2.1-level versus the dollar, a move of approximately 5%. The Chilean Peso, Colombian Peso and the Peruvian Nuevo Sol PEN have all also weakened against the USD in response to a combination of rate cuts and weakening economic data.

We are seeing a deceleration in the Mexican economy with 4Q2012 and 1Q2013 output missing expectations as a result of delays to public spending following the change in government in late 2012. Although banks and retailers are indicating that they anticipate a recovery in the second half of the year, we expect earnings to remain soft. Changes to the VAT framework present a near-term headwind for the consumer and healthcare sectors, and we remain cautious on the telecom and media sectors due to risks emanating from their monopolistic market structures. Within real estate, we have a negative view on

Real GDP Growth – Latin America (YoY %)



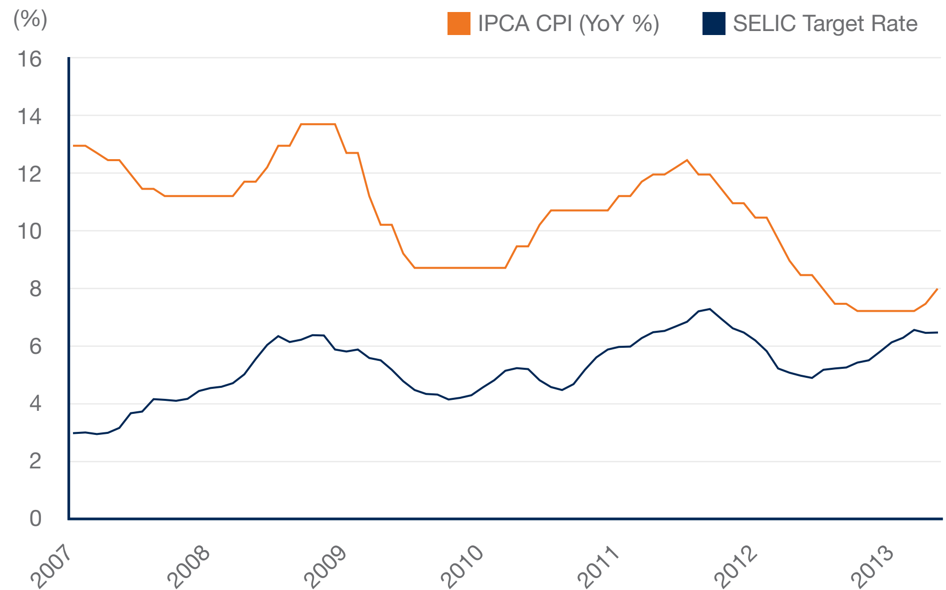
Source: Bloomberg, as of May 2013

the Mexican residential developers, with several listed companies facing liquidity problems, though we are positive on the commercial real estate sector (REITs, or Fibras), including the industrial, office, retail and hotel segments.

Brazil remains out of favor given weak earnings momentum and stagnant economic data. The 1Q2013 earnings season did not deliver any meaningful inflection on earnings trends, and GDP growth expectations for 2013 are converging to ~3%. At the margin, the recent Brazilian inflation data has surprised positively, with the 12m IPCA (CPI) now dipping below 6.5%. Yet, in response to persistent high inflation data, the Brazilian Central Bank surprised markets by raising the Selic base interest rate by 50 bps in May, adopting a more hawkish stance than had previously been seen. We now expect a further 50 bps hike at the next central bank meeting, though at this point we would only expect rates to rise further beyond that in the event of a significant deterioration in the current inflation outlook.

Our preference remains on secular domestic growth stories such as Brazilian retail and apparel, banks across the Latin American region, healthcare and insurance, and certain cyclical opportunities including cement, toll roads and commercial real estate.

Brazil Consumer Inflation vs. SELIC Target Rate



Source: Bloomberg, as of May 2013

We have a cautious view on Mexican telecoms and developers but despite this are selectively positive on Brazilian developers based on an approaching inflection point in cash flow generation and favorable valuations. Exporters across the region may see some benefit from recent currency depreciation, though we do not yet see a compelling long-term investment case for the Brazilian steels or pulp producers, preferring exposure to iron ore and paper / packaging, based on balance sheet strength and superior market positioning.

One recent surprise to us has been the recent improving Petrobras investment case. Although deep issues remain at the NOC (high financial leverage, medium term cash burn and ROCE<WACC) we now anticipate some positive share price relief given the improved earnings outlook. Shares have rallied since March, and now depend upon an improved production outlook to sustain momentum. We do not anticipate this will occur in 2H2013, though would still expect the shares to post a gradual recovery assuming an acceleration in output in the second half of this year.

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